

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of
Zurich Insurance Company : AFFIDAVIT OF MAILING
for Redetermination of a Deficiency or Revision :
of a Determination or Refund of Corporation Tax :
under Article 33 of the Tax Law for the Years :
1978 - 1980.

State of New York :
ss.:
County of Albany :

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 17th day of January, 1986, he served the within notice of Decision by certified mail upon William M. Stroud, the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

William M. Stroud
Zurich Insurance Company
231 N. Martingale Rd.
Schaumburg, IL 60196

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this
17th day of January, 1986.

David Parchuck

James M. Stroud
Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK

STATE TAX COMMISSION

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Zurich Insurance Company
c/o William M. Stroud
231 N. Martingale Rd.
Schaumburg, IL 60196

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David Parchuck

William M. Stroud

Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

January 17, 1986

Zurich Insurance Company
c/o William M. Stroud
231 N. Martingale Rd.
Schaumburg, IL 60196

Gentlemen:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 1090 & 1519 of the Tax Law, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only under Article 78 of the Civil Practice Law and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance
Law Bureau - Litigation Unit
Building #9, State Campus
Albany, New York 12227
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
William M. Stroud
Zurich Insurance Company
231 N. Martingale Rd.
Schaumburg, IL 60196
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petitions	:	
of	:	
ZURICH INSURANCE COMPANY	:	DECISION
for Redetermination of Deficiencies or for	:	
Refunds of Corporation Tax under Article 33 of	:	
the Tax Law for the Years 1978, 1979 and 1980.	:	

Petitioner, Zurich Insurance Company, c/o William M. Stroud, 231 North Martingale Road, Schaumburg, Illinois 60196, filed petitions for redetermination of deficiencies or for refunds of corporation tax under Article 33 of the Tax Law for the years 1978, 1979 and 1980 (File Nos. 37237 and 37451).

A hearing was held before Dennis M. Galliher, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on February 28, 1985 at 10:45 A.M., with all briefs to be submitted by July 29, 1985. Petitioner appeared by its Tax Director, William M. Stroud. The Audit Division appeared by John P. Dugan, Esq. (Paul A. Lefebvre, Esq., of counsel).

ISSUE

Whether the Audit Division properly required petitioner to include in its entire net income interest income from certain bonds issued by a foreign government.

FINDINGS OF FACT

1. On February 12, 1982, the Audit Division issued to petitioner, Zurich Insurance Company ("Zurich"), a Notice of Deficiency asserting additional tax due for 1978 in the amount of \$256,291.00, plus interest. On April 21, 1982, the Audit Division issued two notices of deficiency to Zurich asserting additional

tax due for the years 1979 and 1980 in the amounts of \$17,835.00 and \$64,189.00, respectively, plus interest.

2. By a letter dated August 8, 1983, the Audit Division asserted increases in the respective amounts of the deficiencies previously asserted for 1979 and 1980, such that the deficiencies for these years now asserted are \$84,641.00 and \$96,106.00, respectively, plus interest.

3. On March 30, 1982, Zurich agreed to and paid \$161,841.00 in tax due for 1978. However, interest accrued on this agreed and paid portion of the deficiency for 1978 from March 15, 1979 to March 30, 1982 was not paid. At the hearing, Zurich admitted that such interest is due and is not being contested. For 1978, the amount of the deficiency remaining at issue is \$22,389.00, plus interest.

4. The aforementioned deficiencies, as originally issued and later increased, included assertions that: a) Zurich, as an alien corporation, was not entitled to a retaliatory tax credit, and b) interest income earned on foreign government bonds was properly includible in entire net income ("E.N.I.") for purposes of calculating Zurich's tax liability to New York State.

5. With respect to Finding of Fact "4-a", supra, the New York State Department of Insurance has certified that Zurich is treated as domiciled in New York State under Insurance Law section 32-a, and thus the Audit Division has allowed retaliatory tax credits in reduction of the deficiencies for each of the years in question. Accordingly, the only item at issue is the propriety of including the noted foreign government bond interest income in Zurich's E.N.I. for the subject years.

6. Zurich is an alien corporation which was founded in Switzerland in 1872, and is located at Mythenquaia 2-8002, Zurich Switzerland. By 1912,

Zurich was one of the leading insurance companies on the continent. In a move to diversify into the United States, the "U.S. Branch" was formed in December, 1912. In order for U.S. Branch to conduct business in the United States, it was necessary to be admitted in one of the states. U.S. Branch selected New York as its "port of entry" into the United States, and began doing business in New York State on January 1, 1913. U.S. Branch maintains an office in New York from which it sells casualty insurance.

7. U.S. Branch originally established its office headquarters in Chicago, Illinois, and later moved from there to its present location in Schaumburg, Illinois.

8. Ever since its entry into the United States through New York, U.S. Branch has been considered by New York as an "adopted domestic". New York treats U.S. Branch as a domestic insurer in the administration of the insurance law. New York acts as the lead state in conducting its examination of accounts and New York performs its market analysis the same as it would for any other domestic insurer. Other states recognize this status and allow New York to "head" the statutory examination, market audits, etc., of U.S. Branch.

9. U.S. Branch maintains a separate accounting system from Zurich, and reports to the United States Treasury and to New York State on a separate accounting basis from Zurich. The interest income at issue arose primarily from investments in Canadian government bonds.¹ The bonds in question are listed as assets on the books of U.S. Branch, and on the profit or loss and balance sheets submitted to the New York State Department of Insurance. The

1 The amount of such interest income is \$1,666,506.00 for 1978, \$4,385,263.00 for 1979 and \$8,328,037.00 for 1980.

bonds are physically held either by a brokerage house or by the trust department of a bank either in New York or Schaumburg, Illinois. Interest payments are sent to the place where the bonds are held and are credited to U.S. Branch.

10. Petitioner maintains that since it is subject to Federal income tax under Internal Revenue Code ("I.R.C.") section 864, any income not defined thereunder as "effectively connected" is not subject to tax by New York State and not part of E.N.I. By contrast, the Audit Division seeks to include the interest income by virtue of Tax Law section 1503(b)(2)(B). Petitioner notes that while interest income from German government bonds held in Zurich is not being included in E.N.I. by the Audit Division, the interest income from Canadian government bonds held by U.S. Branch is being included in E.N.I. Finally, petitioner notes that while Tax Law Article 9-A defines E.N.I. as income from within or without the United States [Tax Law §208(c)], there is no comparable section under Tax Law Article 33. In sum, petitioner asserts the Canadian government bond interest is not effectively connected foreign source income such that it is includible in E.N.I. for New York purposes.

11. The parties have stipulated and agreed as follows:

a) if the aforementioned interest income was properly includible in petitioner's E.N.I., then any expenses attributable to earning such interest income would be allowable;

b) if such interest income was not properly includible in E.N.I., then any such expense would not be allowable.

CONCLUSIONS OF LAW

A. That for taxable years commencing on or after January 1, 1974, insurance corporations are subject to two franchise taxes imposed by Article 33 of the Tax Law. Tax Law section 1501 imposes a franchise tax similar to that which is

imposed on business corporations by Article 9-A. Pursuant to Tax Law section 1502, the tax is the greatest amount yielded from four alternative bases, the first being the portion of the taxpayer's entire net income allocated to New York. Tax Law section 1510 imposes an additional franchise tax, similar to that imposed by former Tax Law section 187, measured by the taxpayer's premiums.

B. That Tax Law section 1503 sets forth the manner in which entire net income is to be calculated. Tax Law section 1503(b)(2)(B) provides that entire net income shall be determined without the exclusion, deduction or credit of:

"(A)ny part of any income from dividends or interest on any kind of stock, securities or indebtedness, except as provided in Subparagraphs (A) and (B) of paragraph one hereof (income from subsidiary capital and fifty percent of dividends other than from subsidiaries)."

C. That tax exempt interest may be included in taxable net income for the computation of nondiscriminatory franchise taxes. Northern Finance Corp. v. Tax Commission, 290 U.S. 601 (1933); Werner Machine Co. v. Director of Division of Taxation, 350 U.S. 492 (1956).

D. That Tax Law Article 33 imposes franchise taxes upon insurance corporations rather than taxes on income. These taxes are imposed upon the privilege of doing business in New York in a corporate capacity, and the tax is computed on the value of that privilege, which is measured by income (or some alternate basis). Petitioner is treated as a New York domiciliary, entered the United States through New York, and carries the Canadian bonds on its books rather than on the books of Zurich in Switzerland. The petitioner's income is not taxed directly. Rather, it is used to measure the value of the privilege being taxed, and it properly includes all of the income, including Canadian bond income, of the taxpayer (see Matter of Federal Insurance Company, State Tax Comm., November 9, 1982).


E. That as noted in Finding of Fact "3", interest on the paid portion of the deficiency asserted for 1978, computed from March 15, 1979 to March 30, 1982, is not contested and remains due and owing.

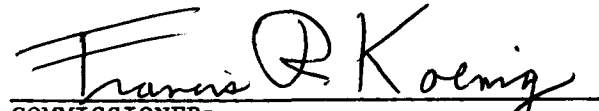
F. That the petition of Zurich Insurance Company is hereby denied and the notices of deficiency issued on February 12, 1982 and April 21, 1982, as modified, are sustained.

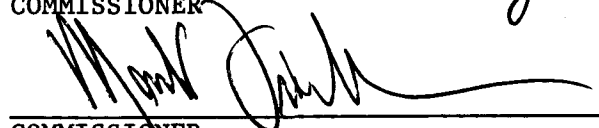
DATED: Albany, New York

STATE TAX COMMISSION

JAN 17 1986


PRESIDENT


COMMISSIONER


COMMISSIONER